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SUBJECT: U/S JEFFERY DISCUSSES OIL AND GAS DEVELOPMENTS IN BRAZIL

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¶1. (U) Summary. U/S Jeffery visited Rio de Janeiro on October 2, 2008 as part of his trip to Brazil. Accompanied by WHA PDAS Craig Kelly and Special Energy Advisor Greg Manuel, U/S Jeffery met with representatives from the U.S. oil and gas industry, industry association IBP (Brazilian Institute for Petroleum, Natural Gas and Biofuels), and state-controlled oil company Petrobras to learn about developments in Brazil's oil and gas sector and discuss how the U.S. and Brazil can foster a closer working relationship on energy issues. Industry as a whole, including U.S. firms and Petrobras, expressed excitement about upstream opportunities in Brazil and were hopeful that the Government of Brazil will reform the regulatory framework in a way that can increase government revenue while still respecting contracts and encouraging competition. U/S Jeffery also met later that evening in Brasilia for a dinner with Mines and Energy Minister Edison Lobao where the talk centered on the promise of pre-salt reserves and ensuring openness to international oil companies. End Summary.

U.S. Oil & Gas Industry

¶2. (SBU) Country managers for U.S. firms Anadarko, Chevron, Devon, and Exxon emphasized to U/S Jeffery that their companies remain interested in building material, sustainable, upstream businesses in Brazil. They said that entering and staying in the Brazilian market hasn't been easy in the ten years since the industry opened up, but that recent discoveries - particularly in deepwater and ultra-deepwater (including pre-salt) areas - have changed the game and made upstream opportunities in Brazil very attractive relative to many other parts of the world. Industry was generally positive about transparency and regulation in Brazil so far, but expressed concern over the nationalistic tone of the current GoB debate on regulatory reform for offshore oil and gas contracts. They thanked Amb. Sobel and the U.S. Mission for their active advocacy over the past few months and asked U/S Jeffery to continue to press for contract stability with GoB interlocutors in Brasilia. At dinner that night with Mines and Energy Minister Edison Lobao in Brasilia, Jeffery noted that the U.S. oil companies had conveyed how happy they were with the current transparent operating structure in Brazil. Lobao responded that the GOB would continue to operate transparently because the international oil community requires it and "we need the capital" that outside involvement brings.

¶3. (SBU) In particular, U.S. industry is seeking to maintain the royalty/tax regime with no change in special participation rate for contracts already in place. Contract sanctity is of special concern on the pre-salt blocks which have already been leased in previous licensing auctions. Anadarko recently became the first non-Petrobras operator to strike oil in Brazil's pre-salt area, and

Exxon and Hess are set to begin drilling their highly anticipated pre-salt block this month. (Note: Before the meeting with U/S Jeffery, Exxon expressed additional concern that some elements within the Brazilian government might attempt "creeping expropriation" if contracts were not adequately grandfathered. End Note.) It was noted that the pre-salt opportunities are too big for just one company to handle and that, even if the GoB wanted to save the whole pre-salt area for Petrobras or a new state-owned company, the financing and investment challenges would be overwhelming.

IBP - Brazilian Institute for Petroleum, Natural Gas and Biofuels

14. (SBU) The Brazilian Institute for Petroleum, Natural Gas and Biofuels (IBP), Brazil's umbrella industry association for domestic and international oil & gas firms, briefed U/S Jeffery on the latest developments in the regulatory reform debate. Shortly following the discovery of oil in the pre-salt area, the debate was thick with emotion and produced some unfortunate nationalistic comments, IBP President Joao Carlos Franca de Luca said. But now, he said, the discussion between government and industry has become much more reasonable and IBP is optimistic that Brazil will maintain a good regulatory framework and preserve a competitive environment. He said that this is a "complicated moment" but that "good sense will prevail."

15. (SBU) IBP believes that some version of the Norwegian regulatory model is the most likely outcome, with a small non-operational state-owned company owning and managing the oil reserves through competitively bid partnerships with international oil companies. Noting the unfortunate coincidence of the timing of the U.S. announcement of the Fourth Fleet and discovery of pre-salt oil in Brazil, De Luca suggested to U/S Jeffery that the USG focus on bilateral cooperation from a technical rather than political perspective. The key to making certain elements of the GoB

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comfortable with a closer energy relationship with the U.S. will be to show how U.S. companies can complement (rather than compete with) Petrobras' knowledge and skills.

Petrobras

16. (SBU) Samir Awad, Petrobras' Global Manager for Business Development, welcomed U/S Jeffery to Petrobras Headquarters and told him that the pre-salt discoveries are having a major impact on the company's business strategy. International operations, which Awad oversees, will be scaled back in order to concentrate resources on domestic opportunities. Overall, international operations make up around 10 percent of Petrobras' operating budget but this figure will go down to 5 percent or even 3 percent, Awad said. Petrobras will likely pull out completely from countries such as Libya, India, Tanzania, and Pakistan. The only countries that Petrobras is not considering scaling back investment are the United States, Argentina, Nigeria, and Angola. The United States is by far the most important country in Petrobras' international portfolio, accounting for 75 percent of the international divisions' budget. By coincidence, Awad said, Petrobras' most attractive upstream opportunities are right in its own backyard in Brazil. He compared the pre-salt opportunities in Brazil to those in Saudi Arabia and Mexico but said that those markets are not as open as in Brazil. Noting the current GoB debate on regulatory reform, he expressed optimism that Brazil would come up with a solution that doesn't hurt the investment climate for Petrobras or other international companies.

17. (SBU) Later that night in Brasilia, MME Minister Lobao also shared with U/S Jeffery how essential he believed the involvement of foreign oil companies was for the future development of the pre-salt resources in Brazil. He noted that he had recommended to Petrobras and ANP that they work together to study how they can best work together with U.S. industry to manage the resources that he believes will eventually finance a "Marshall Plan" to address Brazil's domestic education woes.

18. (SBU) While at Petrobras, U/S Jeffery and Amb. Sobel also had a short, private meeting with the company's Chief Financial Officer

Almir Barbassa.

19. (U) This message was cleared/coordinated with Embassy Brasilia and the delegation.

MARTINEZ